90-984

(1)

No. —

IN THE
Supreme Court of the United States
OCTOBER TERM, 1990

KANSAS GAS AND ELECTRIC COMPANY,
Petitioner,
v.
STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS, et al,
Respondent.

Petition for a Writ of Certiorari to the Court of Appeals of the State of Kansas

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PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Under the Federal Power Act, the Federal Energy Regulatory Commission (FERC) has exclusive jurisdiction to regulate wholesale electric rates and to set the terms and conditions of wholesale interstate electric transactions. This case presents a question involving the power of state regulatory commissions to nullify FERC's regulation and otherwise to burden the sale of wholesale electric power across state lines:

> Whether the Federal Power Act permits a state regulatory commission, in setting intrastate retail rates of a seller of wholesale power, to reject the interstate wholesale rates established by FERC and to impute a wholesale rate that is greater than the FERC-filed rate?

PARTIES BELOW

Kansas Gas and Electric Company was an appellant in the Kansas Court of Appeals. Beech Aircraft Corporation, The Coleman Company, Inc., LaFarge Corporation, Total Petroleum, Inc., and Texaco, Inc., were also appellants in the Kansas Court of Appeals on issues unrelated to those raised in this Petition.

The appellee was the State Corporation Commission of the State of Kansas.

The Citizens' Utility Ratepayers Board intervened in the case below before the Kansas Court of Appeals.

RULE 29.1 STATEMENT

Kansas Gas and Electric Company owns an 80 percent interest in CIC Systems, Inc., and a 47 percent interest in both the Wolf Creek Nuclear Operating Corporation and in the Utility Fuels Company. Kansas Gas and Electric Company currently has no parent company. Kansas Gas and Electric Company and Kansas Power and Light Company signed an agreement on October 28, 1990 to merge those two companies. Under the agreement, which has been approved by the boards of directors of both companies but has not yet received shareholder or regulatory approval, Kansas Gas and Electric Company would become a wholly-owned subsidiary of Kansas Power and Light Company.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Kansas Gas and Electric Company (KG&E) respectfully prays that a writ of certiorari issue to review the judgment and opinion of the Kansas Court of Appeals entered in Case No. 90-64976-A on June 29, 1990.

OPINIONS BELOW

The opinion of the Kansas Court of Appeals (Appendix 1a) is not reported. The February 13, 1990 Order of the State Corporation Commission of the State of Kansas (KCC) in Docket No. 142,098-U, 84-KG&E-197-R (Appendix 25a) is not reported.

JURISDICTION

On September 20, 1990, the Kansas Supreme Court denied KG&E's Petition for Review of the June 29, 1990

opinion of the Kansas Court of Appeals (Appendix 24a). This court has jurisdiction under 28 U.S.C. § 1257(a).[1]

CONSTITUTIONAL AND STATUTORY PROVISIONS

The United States Constitution, Article VI, Clause 2: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land. . . ."

The pertinent provisions of the Federal Power Act, 16 U.S.C. §§ 824-824e, are reprinted at Appendix 183a.

STATEMENT OF THE CASE

Introduction

This case stems from the ongoing tension between FERC's exclusive authority over interstate wholesale power transactions and the local sphere of interest of state utility regulators. Nationwide, wholesale electric power is produced from many sources and then transmitted across state borders to local electric utilities for resale. These power sources produce electricity at widely varying costs, leading to disputes between states or between state and federal regulators over the appropriate

[1] The Kansas Court of Appeals held that the KCC in setting KG&E's retail rates had authority to assume that KG&E had collected a higher level of revenues on an interstate power sale than was permissible under the FERC-filed rate. The court of appeals rejected KG&E's arguments that the KCC's orders imputing revenues above the FERC rate were contrary to federal law and the Supremacy Clause because they intruded on an area preempted exclusively to FERC's jurisdiction. Orders by state utility regulators have long been viewed as "state statutes" within the meaning of 28 U.S.C. § 1257. *Lake Erie & Western Ry. Co. v. State Pub. Utils. Comm'n*, 249 U.S. 422, 424 (1919). *See generally Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986). The recent amendments to 28 U.S.C. § 1257 that narrowed the category of appeals which can be brought before this Court do not demonstrate a congressional intent to alter this long-standing interpretation of the phrase "state statute" as used in 28 U.S.C. § 1257.

allocation of these wholesale power supplies and their costs. Each state understandably desires to retain as much of the inexpensive power generated within its state as possible, while shielding its citizens from the costs of more expensive sources of generation.

Under the Federal Power Act, FERC has exclusive jurisdiction over interstate wholesale power transactions and the resulting wholesale rates and costs. (Appendix (App.) 183a). FERC thus determines both the wholesale cost a utility incurs for purchasing power for resale to its customers as well as the revenues the producing utility receives for selling its power at wholesale. This case presents a direct challenge to FERC's exclusive jurisdiction over rates for wholesale power sold in interstate commerce.

The KCC reduced KG&E's retail rates by imputing to KG&E greater revenue from the wholesale interstate sale of power to the Oklahoma Municipal Power Authority (OMPA) than KG&E is permitted to (or did) collect under its FERC-filed rates. The KCC's rationale was that it was unfair for KG&E to offer "its cheapest and lowest cost capacity to another [utility], while including its highest cost capacity in rates paid by its jurisdictional, captive ratepayers." (App. 58a).

The KCC's references to the "lowest cost" and "highest cost" capacity relate to the fact that KG&E sold at wholesale to OMPA power generated from its gas-fired Gill and Evans plants. These gas-fired plants are KG&E's lowest cost sources of electric capacity, and the FERC-filed rates for this wholesale transaction reflected the low capacity costs of these facilities. KG&E's most expensive source of electric capacity is the Wolf Creek Generating Station ("Wolf Creek"), a nuclear plant, which was not included in the transaction with OMPA.[2] The KCC's view was

[2] The cost of producing electricity has several components, including the capital cost of the plant, fuel expenses, and operating

that OMPA was obtaining the benefit of KG&E's lowest cost capacity through a wholesale interstate transaction while KG&E's Kansas customers were being required to purchase the more expensive Wolf Creek capacity.

To remedy this perceived unfairness, the KCC simply pretended that the power KG&E sold to OMPA came from Wolf Creek. The KCC determined what additional revenues KG&E would have collected from OMPA if the sales had been based on Wolf Creek's costs instead of Gill's and Evans' costs. This phantom revenue, amounting to $13.5 million, was then imputed to KG&E and its intrastate retail rates were reduced by that amount.

The factor underlying this imputation of phantom revenue, and the entire OMPA transaction, is the Wolf Creek plant. Since the plant's completion in 1985, the KCC's ratemaking treatment of Wolf Creek has dominated KG&E's relationship with the KCC. The Kansas Court of Appeals concluded that there was a "close relationship between this case and the prior Wolf Creek rate case." (App. 3a). The KCC's rate treatment of Wolf Creek has previously been raised before this Court, which noted probable jurisdiction on February 23, 1987 of KG&E's appeal arising from the KCC's initial rate treatment of Wolf Creek in 1985.[3] At the KCC's request, the Court subsequently dismissed that appeal as moot when the KCC issued new orders in March 1987 modifying the rate treatment of the plant.[4] The present case springs

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and maintenance costs. Fossil fuel plants typically have lower capital costs than nuclear plants, while nuclear fuel is typically less expensive than fossil fuel. The reference to the differing "capacity" costs of Gill and Evans and Wolf Creek refers to the capital cost of those plants. Gill and Evans are older fossil plants and have a much lower capital, or "capacity," cost than the newer Wolf Creek nuclear plant.

[3] *Kansas Gas & Elec. Co. v. State Corp. Comm'n of Kansas*, 479 U.S. 1082 (1987).

[4] *Kansas Gas & Elec. Co. v. State Corp. Comm'n of Kansas*, 481 U.S. 1044 (1987).

from the KCC's initial 1985 rate treatment of Wolf Creek, its March 1987 orders revising that treatment, and KG&E's actions taken in response to those orders.

Background [5]

The Initial Wolf Creek Decision.

Like all contemporary nuclear plants, Wolf Creek cost considerably more than initially estimated. In addition, customer demand for electricity from KG&E when the plant was completed was lower than had been anticipated when construction commenced. In 1985, KG&E requested a retail rate increase to recover its investment in Wolf Creek. The KCC Chairman has described the KCC's initial response as one of "brinkmanship," where KG&E's rates were set as low as possible "without bankrupting KG&E or jeopardizing its ability to provide safe and adequate electric service." (App. 82a).

The KCC refused to include a large portion of Wolf Creek in rate base [6] because KG&E did not need that part

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[5] The background information is contained in numerous orders of the KCC spanning a five-year period. Because there is no dispute about this historical background, and because of the volume of the KCC orders, not all of these materials have been included in the Appendix. This background information is well summarized in the KCC Chairman's dissent to the February 13, 1990 order that imputed the phantom revenue to KG&E. (App. 80a). The initial Wolf Creek decision by the KCC, *Re Wolf Creek Nuclear Generating Facility*, is reported at 70 P.U.R. 4th 475 (Kan. Corp. Comm'n 1985).

[6] Rate base is a utility's undepreciated investment in the assets used to provide public service. C. Phillips, *The Regulation of Public Utilities*, 301 (2nd ed. 1988). The rates a utility is allowed to charge are determined largely by its rate base. Rate regulation sets rates at a level that provides the utility an opportunity to earn revenues to cover its operating expenses and capital costs. That level of revenues typically is defined as:

Revenue Requirement = Operating Expenses + (Rate Base x Weighted Average Cost of Capital).

When rate base or operating expenses are reduced the utility's revenue requirement decreases and its rates are set at a lower level.

of the plant to meet its demand from customers for electricity. *Re Wolf Creek Nuclear Generating Facility*, 70 P.U.R. 4th 475, 515-16 (Kan. Corp. Comm'n 1985). In making that adjustment, the KCC recognized that part of Wolf Creek's capacity could be required to offset the retirement of KG&E's 92 megawatt (MW) Ripley Station (Ripley). It included 46 MW of Wolf Creek in rate base immediately to compensate for the retirement of Ripley. *Id.* at 514. The KCC also concluded that an additional 46 MW of Wolf Creek could be added to rate base later to replace the remainder of Ripley if KG&E demonstrated the prudence of retiring that plant. *Id.*

The resulting rate increase approved by the KCC was to be phased-in through four separate increases over several years. KG&E appealed the KCC's decision to the Kansas courts and eventually to this Court, which noted probable jurisdiction. Several other events occurred prior to that time that bear directly on this case.

The OMPA Sale.

The KCC recognized that it had accorded KG&E very harsh economic treatment in its ratemaking of Wolf Creek. (App. 124a). The KCC Chairman has stated that "we tilted the scales heavily toward KG&E's customers and challenged KG&E to figure out how to bring the scales into balance without further rate increases, if possible. . . . As an incentive to seriously face that challenge, we held KG&E's Wolf Creek rate increase to the lowest possible level." (App. 82a).

Without the option of increasing its prices, KG&E's only options for meeting the challenge imposed by the KCC were to reduce costs and to increase sales. KG&E made serious efforts to implement both options, including searching for new markets in which to sell its electricity. One successful effort was KG&E's sale to OMPA. On May 22, 1986, KG&E entered into a Participation Power Agreement with OMPA under which KG&E sold

OMPA 41.2 MW of capacity from KG&E's gas-fired Evans and Gill plants. (App. 166a). OMPA needed the purchased capacity only 14.4 percent of the time, so a sale of the much more expensive base load capacity from Wolf Creek to OMPA was not a viable option. (App. 57a).[7]

The OMPA sale was an interstate sale of wholesale power and therefore subject to FERC's exclusive jurisdiction. On May 22 and June 16, 1986, KG&E filed the Participation Power Agreement with FERC in accordance with 16 U.S.C. § 824d(c). (App. 162a). KG&E also served a copy of the agreement on the KCC at that time. In addition, FERC gave public notice of KG&E's filing in the Federal Register. Neither the KCC nor any other party intervened, filed comments or protested. *Id.* FERC, therefore, allowed the OMPA Participation Power Agreement and the accompanying wholesale rates to become effective as of July 1, 1986. (App. 163a).

The Second Wolf Creek Decision.

As KG&E negotiated and concluded the sale to OMPA, its appeals of the KCC Wolf Creek ratemaking orders proceeded through the Kansas courts. The Kansas Supreme Court affirmed the KCC's actions and KG&E appealed to this Court, arguing that the KCC's valuation of Wolf Creek and the resulting rates were so low they constituted a confiscation of KG&E's property. This Court noted probable jurisdiction on February 23, 1987.[8]

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[7] As noted above (*supra* note 2), the cost of producing electricity includes both the capital or fixed costs of a generating facility (capacity cost) and the costs of operating the facility (energy cost). Both these costs are included in the price a generator sets for its electricity. A utility that needs to purchase power only occasionally will typically be more concerned with capacity costs than with energy costs, because capacity costs remain constant but energy costs vary according to demand.

[8] *Kansas Gas & Elec. Co. v. State Corp. Comm'n of Kansas*, 479 U.S. 1082 (1987).

Very shortly thereafter, the KCC on March 11, 1987, issued another order relating to Wolf Creek that made several substantial revisions to the ratemaking treatment of that plant. (App. 121a). It made each of the four-step rate increases (some of which had not yet been implemented) permanent (App. 151a); in addition, it added the remaining revenue impact of the Ripley retirement [9] to the permanent third phase of the increase, to become effective on January 1, 1989. (App. 134a). The inclusion of revenues related to the Ripley retirement was conditioned on the following:

> [I]t is reasonable to assume that KG&E's need for Wolf Creek, whether from peak growth or reduced overall generating capability, will have grown by 41 MW from 1986 to 1988. . . . Also, as a condition precedent to the inclusion of revenues associated with the Ripley retirement in the January 1, 1989, rate increase, we direct the company to show the Commission that this . . . has occurred.

(App. 134a-35a).

On the strength of its "final" Wolf Creek ratemaking order, the KCC moved this Court on April 13, 1987, to dismiss KG&E's appeal of the initial Wolf Creek orders as moot. (App. 154a). Anticipating KG&E's argument that the case was not moot, the KCC argued:

> In this instance, the specific basis for each of the issues on appeal has been completely changed by the subsequent order making rates permanent. *Furthermore, the March 11, 1987 Commission order contemplates that the framework it establishes will govern*

[9] The revenue impact of the Ripley retirement consisted of adding the cost of 46 MW of Wolf Creek capacity into rate base and thus into KG&E's revenue requirement. *See supra* note 6. The KCC found in a March 19, 1987 order that KG&E had acted prudently in retiring Ripley, which was one of the conditions precedent to including the additional 46 MW of Wolf Creek into rate base. (App. 27a).

> *the setting of KG&E's rates for the remaining operational life of Wolf Creek.*

(App. 158a-59a) (emphasis added). This Court granted the KCC's motion and dismissed KG&E's appeal. *Kansas Gas & Elec. Co. v. State Corp. Comm'n of Kansas*, 481 U.S. 1044 (1987).

The KCC Proceedings at Issue.

Under the ratemaking structure the KCC adopted in its March 13, 1987 order—the framework it told this Court would govern the setting of KG&E's rates for the remaining life of Wolf Creek—the third phase of the Wolf Creek rate increase was to take permanent effect on January 1, 1989. At that time, 46 MW of Wolf Creek would be added to rate base to replace the remainder of Ripley if KG&E could demonstrate that during 1986-88 it had experienced either a growth in peak demand or a reduction in generating capability totalling 41 MW. In a December 30, 1988 order, the KCC concluded that KG&E had in fact met the 41 MW condition and thus inclusion of 46 MW of Wolf Creek in the third-phase rate increase was appropriate. (App. 106a).

Despite its prior statements concerning the permanent status of these rates, the KCC refused to make the 46 MW of Wolf Creek portion of the third-phase increase permanent. Rather, it made this $14.4 million part of the increase interim and subject to refund, pending the results of an audit of KG&E's cost of service. (App. 105a).

The KCC Staff conducted an audit of KG&E's cost of service during 1989 and concluded that KG&E's revenues were $18.4 million less than its cost of serving its retail customers. The Staff recommended that the Wolf Creek-related $14.4 million increase be made permanent. (App. 34a). KG&E's own cost of service study showed an even greater revenue deficiency, but KG&E concurred with the Staff recommendation. *Id.*

Intervenor Citizens' Utility Ratepayers Board ("CURB"), a consumer advocate organization, proposed that KG&E's revenue requirement be *reduced* by $51.3 million. CURB's proposal was based on several adjustments to KG&E's actual operating results, including the imputation to KG&E of an additional $13.5 million from the OMPA sale. This phantom revenue reflected the additional revenue KG&E would have received had it sold electricity from Wolf Creek to OMPA, rather than electricity from its gas-fired Gill and Evans plants. (App. 34a, 56a).

The KCC accepted CURB's proposed imputation of $13.5 million of phantom wholesale revenues and ordered KG&E to reduce its retail rates. The KCC reasoned that the imputation was appropriate to protect KG&E's retail Kansas customers, because KG&E's sale to OMPA was "a case of one utility selling its cheapest and lowest cost capacity to another, while including its highest cost capacity in rates paid by its jurisdictional, captive ratepayers." (App. 58a). The KCC believed that unfairness to be enhanced by KG&E's use of the off-system sale to justify in part the inclusion of the additional 46 MW of Wolf Creek capacity in its rates to replace Ripley.[10] The KCC concluded that, although it had encouraged KG&E to seek off-system sales like the OMPA sale, it would not

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[10] As noted above, the KCC concluded in its December 30, 1989 order that KG&E had met the condition precedent for including the additional Wolf Creek capacity in the third-phase increase. (App. 106a). The condition precedent was disjunctive: KG&E could meet it by showing a 41 MW increase in peak demand *or* a 41 MW reduction in generating capability. The KCC found in its February 13, 1990 order that KG&E had used the OMPA sale to meet the reduced generating capability part of the condition precedent. (App. 58a). KG&E had also met the part of the condition precedent relating to an increase in peak demand. (App. 104a, 106a). The KCC concluded in its February 13, 1990 order, however, that KG&E had improperly used interruptible sales contracts to meet this condition. (App. 55a).

condone such sales "if their effect is to increase rates for Kansas customers. . . ." *Id.*

On March 5, 1990, KG&E filed a Petition for Reconsideration with the KCC. Among other grounds, KG&E presented the KCC with the following:

> The Commission's Finding at Paragraphs 26, Pages 38 through 41, That Decreases KG&E's Revenue Requirement By Imputing $13.5 Million of Additional Revenue to KG&E's Off-System Sale to the Oklahoma Municipal Power Authority (OMPA) Is Unconstitutional Under the Supremacy Clause of the Constitution.

KG&E Petition for Reconsideration, March 5, 1990, p. 13. On March 21, 1990, the KCC entered an order denying KG&E's Petition for Reconsideration (App. 100a).

The Kansas Court of Appeals Decision.

On April 2, 1990, KG&E applied for judicial review of the KCC's order by the Kansas Court of Appeals. In its application, KG&E presented the following question to the court of appeals:

> Whether the Challenged Orders Are Unlawful Because They Impute Revenue To A Federally Regulated and Approved Wholesale Power Contract in Violation Of The Supremacy Clause of the United States Constitution.

KG&E's Brief of Appellant, April 23, 1990, p. 2.

The court of appeals entered its opinion in the case below on June 29, 1990. (App. 1a). After devoting several pages to an analysis of FERC's exclusive jurisdiction over wholesale power rates and the corollary filed rate doctrine, the Kansas Court of Appeals concluded that the filed rate doctrine only "ensures that the *buyer* of the wholesale power is allowed to recover its approved costs from the ratepayer." (App. 18a) (emphasis added).

The court reasoned that because previous applications of the filed rate doctrine involved purchasers of wholesale power, the doctrine had no relevance to a case involving state regulation of a seller of wholesale power in interstate commerce. *Id.* The Kansas Court of Appeals affirmed the KCC's imputation of additional revenues to the OMPA sale. (App. 19a).

On July 20, 1990, KG&E petitioned the Kansas Supreme Court to review the court of appeals decision. KG&E presented the following question for the Kansas Supreme Court's review:

> Whether The Court Erred in Permitting An Imputation of Revenues to An Off-System Sale Subject to FERC's Jurisdiction In Disregard of Preemptive Effect Accorded the Determination of the FERC Under The Supremacy Clause of the United States Constitution.

Petition for Review by Appellant KG&E, July 20, 1990, p. 2.

The Kansas Supreme Court denied KG&E's Petition for Review on September 20, 1990. (App. 24a).

REASONS FOR GRANTING THE WRIT

I. THE QUESTION PRESENTED IS OF NATIONAL IMPORTANCE

More than half a century ago, Congress in enacting Section II of the Federal Power Act recognized the importance of wholesale interstate power transactions to the welfare of the nation. To foster such transactions, Congress developed comprehensive federal regulation designed to insulate wholesale interstate power sales from the inconsistencies and parochialism inherent in state regulation.[11] Congress' foresight was astute; a foundation of the industrialization and economic development of the United States has been the availability and reliability of bulk power supplies. The transfer of wholesale power from differing sources into interstate commerce for resale in different states has become a common element of the national economy.

Given the current and projected status of the nation's power supply, interstate power transactions are becoming increasingly necessary to maintain a baseline level of power availability. The demand for electricity continues to grow in this country, but very few electric utilities are building plants to meet this demand. Having witnessed the treatment by state regulators of new plant costs over the last decade, a process in which utilities were denied recovery of billions of dollars of their investments, many utilities are hesitant to put additional cap-

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[11] When Congress enacted the Federal Power Act in response to *Pub. Utils. Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927), where this Court held that the Commerce Clause limited state regulatory authority over interstate sales of power at wholesale, Congress did more than fill that regulatory gap with a federal presence. Congress completely excluded state regulation of such transactions, effectively replacing the flexible balancing test used to limit state authority to affect interstate commerce with a bright line separating federal and state authority. *See FPC v. Southern California Edison Co.*, 376 U.S. 205, 212-216 (1964).

ital at risk in new construction programs.[12] As a result, the threat of near-term shortfalls of electric capacity on the order of hundreds of thousands of megawatts is very real.[13]

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[12] Between 1980 and 1986, state regulators disallowed more than $6 billion (approximately 10 percent) of utilities' investments in new plant construction from inclusion in rate base. Oak Ridge National Laboratory, *Prudence Issues Affecting the U.S. Electric Utility Industry*, pp. 3, 43-44 (December 1987). The Oak Ridge study concluded that:

> Cost disallowances for many utilities threaten the economic health of the companies. The disallowances, which deny full construction cost recovery to utilities, have had a negative effect on the ordering of any new base load power plants, either nuclear or coal. They have contributed to the fact that no nuclear plants have been ordered since 1978, and none are currently being planned in the U.S. This situation has led to a major national concern that adequate, reliable and economic electric power may not be available to meet future needs of the country.

Id. at v.

The Department of Energy also has recognized the chilling effect that recent regulatory practice is having on utility investment in generating capacity:

> The present climate of utility regulation in many states discourages new capital investment, and this restricts the range of new supply options that might otherwise be considered. A fundamental responsibility of a utility regulator is to balance customers' welfare with that of company stockholders; but in recent years the traditional compact in such regulation (which balanced limited risks with limited rewards) has been broken.

U.S. Dep't of Energy, *Energy Security—A Report to the President of the United States*, p. 154 (March 1987). *See also In re Boston Edison Co.*, Docket No. 85-266A (Mass. Dep't of Pub. Util., June 26, 1986) (utility refused to construct new generating capacity in order to avoid the risk of having its substantial construction costs disallowed by state regulators).

[13] The United States Energy Information Administration (EIA) expects sales of electricity to grow 2.3 percent annually through the year 2010, reaching 4300 terawatthours (billions of kilowatthours). Based on its analysis of demand for electricity and the ability of utilities to meet this demand, the EIA recently projected

Despite the projected national power supply shortage, some utilities have more capacity to generate electricity than they need to serve their own customers. Through wholesale and interstate power sales, these utilities can mitigate a national shortfall by helping others supply the requirements of their customers. Transactions between those with additional capacity and those without sufficient capacity will be increasingly important as the nation's power supply dwindles.

The feasibility of such transactions decreases, though, when parochial state concerns are permitted to intrude. The states in competitively seeking industry, commerce, labor, and other fundamental elements of the nation's economy, have a narrower view of the public good than is required to meet national needs. Those narrow interests have prompted states in recent years to attempt to alter the terms of interstate transactions by reserving the benefits of inexpensive hydropower for their citizens, *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), and by rejecting an allocation of nuclear plant costs that would increase their citizens' rates. *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988).[14] The same type of narrow

that "the need for additional capacity *beyond what utilities have announced* ranges from 183 to 267 gigawatts by 2010." U.S. Energy Information Administration, *Annual Outlook for U.S. Electric Power 1990*, pp. 9-10 (June 1990) (emphasis added). Similarly, the Utility Data Institute, Inc., projects that the nation will need between 100,000 and 200,000 MW of new generating capacity by the year 2000; despite these projected increases in demand, utilities have planned to add less then 40,000 MW by that time and only 16,000 MW is actually under construction. *UDI: U.S. Generating Capacity Won't Meet Demand by 2000*, Electric Light & Power, June 1990 at 54.

[14] Another parochial state approach to regulation of the electric industry was addressed in *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1982), where this Court overturned an order by the New Hampshire Utilities Commission that prohibited out-of-state sales of New England Power's inexpensive hydroelectric

interest prompted the KCC here to impute revenue in an interstate wholesale transaction to KG&E; in a straightforward display of protectionism, the KCC concluded that the interstate sale was unfair to the citizens of Kansas because the inexpensive capacity was being sold interstate while more expensive capacity was being charged to in-state customers.

FERC has been given exclusive jurisdiction over interstate and wholesale transactions to avoid this type of inconsistent and hostile state regulation that detracts from the overall national interest. *Jersey Cent. Power & Light Co. v. FPC*, 319 U.S. 61, 68 (1943). This Court has in recent years provided guidance on the parameters of the distinct spheres of regulation accorded to FERC and to the states. *See Mississippi Power*, 487 U.S. 354 (1988); *Nantahala*, 476 U.S. 953 (1986).[15] Although the Court in these decisions clearly defined FERC's jurisdiction as exclusive, there is evidence that state regulators have not heeded the message. In a recent industry publication, the heads of 14 local regulatory commissions were given a forum to address the issues and problems facing the utility industry. They were asked whether, in light of the increasingly regional or national nature of utility activities, FERC was "swallowing up state regulation."

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power. *Id.* at 335-36. The only difference between *New England Power* and this case is that New Hampshire attempted to further its own interests by prohibiting exportation of cheap power, whereas Kansas sought the same by exacting an economic penalty for interstate sales of inexpensive power.

[15] *Mississippi Power* and *Nantahala* specifically address the preemptive force of FERC's ratemaking authority and thus are of particular relevance to this case. This Court, however, has clearly defined the separation between FERC's exclusive jurisdiction and the authority of the states in other regulatory areas. *See, e.g.*, *California v. FERC*, 110 S. Ct. 2024 (1990) (preemptive effect of FERC's establishment of minimum stream flow rates for hydroelectric project); *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293 (1988) (FERC's exclusive authority over the capital structure of regulated utility).

The 1990 Utility Regulators' Forum, Public Utilities Fortnightly, November 8, 1990 at 37. Several of the responses indicated that state regulators are reluctant to accept the full scope of FERC's authority.

For example, the Chairman of the Tennessee Public Service Commission responded that "[f]ederal agencies are too often too willing to preempt state regulation." *Id.* The President of the North Dakota Public Service Commission opined that "FERC is swallowing up significan areas of state regulation." *Id.* at 42. Similarly, Chairman Worthy of the District of Columbia Public Service Commission conceded that "[n]ational regulatory interests do not always coincide with local regulatory interests" and observed, with apparent regret, that "[t]he state/federal regulatory structure of the energy utility industry creates opportunities for FERC to continually exert jurisdiction. . . ." *Id.* at 43. In Chairman Worthy's view, state regulatory authority "is similar to the concept of representation of the people and by the people. This localization of regulatory functions serves to prevent regulation by the fiat of the federal government." *Id.*

The decision of the Kansas Court of Appeals also demonstrates that the respective limits of state and federal regulation are not well understood, or perhaps still not well accepted, by the states. That court's approval of an imputation of revenue to a wholesale seller of power in interstate commerce, based on an interpretation of the Federal Power Act limiting FERC's exclusive jurisdiction solely to purchasers, has serious ramifications for the wholesale interstate power market. This interpretation removes FERC's authority to regulate the actions of wholesale sellers and effectively transfers that regulatory authority to the states. In effect, this interpretation of the Federal Power Act essentially empowers the states to determine the rate structure for interstate power sales guided by the needs and desires of their citizens and without regard to the national interests at stake.

The KCC's exercise of authority is incompatible with the congressional purpose behind the enactment of the Federal Power Act. Above all else, Congress intended to create a uniform system of regulation to promote the orderly development of the interstate power market necessary for the nation's economic growth. That objective cannot be achieved if, as the court below held, the states are not bound by FERC's determinations that affect the retail activities of a seller of wholesale power.

Resolution of the conflict concerning FERC's authority over wholesale sellers is a matter of great national significance. Interstate and wholesale power transactions between utilities have been and will continue to be an important and integral part of the national economy. The decisions by utilities relating to those transactions are being made in reliance on FERC's exclusive jurisdiction over such arrangements. State commissions like the KCC are continuing to impose a "rate structure" and an allocation of costs between states that will "benefi[t] its residents to the detriment of its neighbors." [16] This issue should be resolved now.

II. THE FEDERAL POWER ACT PREEMPTS KANSAS' IMPUTATION OF REVENUE TO INTERSTATE POWER SALES

Congress provided for exclusive federal jurisdiction over interstate and wholesale electric transactions so that exchanges important to the national economy would not be impaired by state action. To avoid this impairment, FERC has been vested with exclusive jurisdiction under the Federal Power Act to regulate the rates for electric energy "for resale," to regulate the "transmission of electric energy in interstate commerce," and to allocate whole-

[16] *Massachusetts v. United States*, 729 F.2d 886, 888-89 (1st Cir. 1984); *See Middle South Energy, Inc. v. Arkansas Pub. Utils. Comm'n*, 772 F.2d 404, 416-17 (8th Cir. 1985), *cert. denied*, 474 U.S. 1102 (1986).

sale power supplies and their costs among utilities in different states. 16 U.S.C. § 824. (App. 183a-88a). FERC thus determines, based on rate schedules filed with or approved by it, the wholesale rate a utility may charge for selling power to another for resale.

Despite these statutory provisions, the Kansas Court of Appeals has held that in setting retail rates for utilities engaged in selling power at wholesale, state regulatory commissions have unlimited discretion to ignore the FERC-filed rates governing wholesale transactions. Under the court's holding, a state regulator may pretend, for purposes of intrastate retail ratemaking, that the wholesaling utility received more revenue for the interstate sale than it was permitted to under its FERC-filed rates. (App. 18a). The Kansas court found that pretense permissible when the state regulator concludes that the interstate sale is "a case of one utility selling its cheapest and lowest cost capacity to another, while including its highest cost capacity in rates paid by its jurisdictional, captive ratepayers." (App. 58a).

This regulation by pretense, which results in unrecoverable "trapped costs," [17] conflicts with the decisions of this Court and with the intent of the Federal Power Act.

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[17] Trapped costs occur when state regulators set retail rates that prohibit full recovery of the revenue requirement generated by FERC-approved wholesale arrangements. In *Nantahala*, the FERC-mandated expense of purchasing wholesale power was trapped. *Nantahala*, 476 U.S. at 971-72. In this case, the KCC's order traps the cost of producing power instead of the cost of purchasing power. FERC allows KG&E to charge OMPA only for the cost of power generated at the Evans and Gill plants. That wholesale rate structure makes the cost of producing a like amount of power at Wolf Creek a part of KG&E's retail revenue requirement. *See supra* note 6. The KCC prevented KG&E from recovering those Wolf Creek costs by pretending that FERC had allowed them to be charged to OMPA. Thus, as in *Nantahala*, KG&E is left with unrecoverable costs because it is bound by FERC-filed rates that the state regulators disregarded.

The Federal Power Act preempts state regulators from "directly" or "indirectly" regulating interstate wholesale rates that are subject to FERC's jurisdiction. *See N. Natural Gas Co. v. State Corp. Comm'n*, 372 U.S. 84, 90-92 (1963).[18] To ensure complete adherence to wholesale rates regulated by FERC, this Court established the filed rate doctrine. Under that doctrine, state regulators and utilities:

> can claim no rate as a legal right that is other than the filed rate, whether fixed or merely accepted by the Commission, and not even a court can authorize commerce in the commodity on other terms. . . .
>
> [T]he right to a reasonable rate is the right to the rate which the [FERC] files or fixes and . . . the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more responsible one.

Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co., 341 U.S. 246 (1951).

Despite the clear holding in *Montana-Dakota*, the Kansas Court of Appeals authorized the KCC to assume that "commerce in the commodity on other terms" had in fact occurred. While agreeing that the filed rate doctrine would preclude a state from prohibiting full recovery of the costs a wholesale purchaser pays under a FERC rate, the court concluded that the doctrine did not apply to sellers of wholesale power that recover the FERC rate. The Kansas Court distinguished this case from *Nantahala* and *Mississippi Power* through a narrow construction of this Court's decisions that limited the filed rate doctrine to wholesale purchasers.[19]

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[18] Although *N. Natural Gas* was decided under the Natural Gas Act and not the Federal Power Act, this Court has recognized that the two statutes are substantially identical and therefore cites interchangeably cases arising under both Acts. *Arkansas-Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n. 7 (1981).

[19] An additional ground cited by the court below for upholding the KCC's order was that the KCC was not regulating the same

This mechanistic view of FERC's jurisdiction as unilateral misapprehends the nature of the filed rate doctrine and the preemptive force of FERC's jurisdiction. The fundamental principle underlying the filed rate doctrine's application to state action is that " 'there can be no divided authority over interstate commerce, and . . . the acts of Congress on that subject are supreme and exclusive.' Consequently, state efforts to regulate commerce must fall when they conflict with or interfere with federal authority over the same activity." *Chicago & N. W. Transp. Co. v. Kalo Brick & Tile Co.*, 450 U.S. 311, 318-19 (1981) (quoting *Missouri Pac. R. R. Co. v. Stroud*, 267 U.S. 404, 408 (1925)). If state regulation undermines or interferes with FERC's exclusive jurisdiction over wholesale interstate sales, regardless of whether the interference affects a purchaser or a seller, the state regulation cannot stand. *See Appalachian Power Co. v. Pub. Serv. Comm'n of West Virginia*, 812 F.2d 898, 904-05 (4th Cir. 1987).

In *Nantahala* and *Mississippi Power*, this Court overturned attempts by state authorities to establish retail rates for intrastate sales of power which did not give

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activity as FERC. (App. 19a). The basis for that conclusion was that the KCC's actions did not prevent KG&E from selling power to and collecting its FERC-filed rate from OMPA. (App. 18a). The fact that the state action does not require KG&E to violate FERC's order does not save the KCC's order from the preemptive effect of FERC's jurisdiction. This Court squarely rejected that argument in *Nantahala*. *See Mississippi Power*, 487 U.S. at 371. The Kansas court's reasoning ignores the well-established precept that federal preemption of state action does not require that compliance with both the federal and state laws be impossible. The Supremacy Clause also prohibits state action that "stands as an obstacle to the accomplishment of the full purposes and objectives of Congress." *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 300 (1988); *See also Appalachian Power Co. v. Pub. Serv. Comm'n of West Virginia*, 812 F.2d 898, 904 (4th Cir. 1987) ("Preemption principles deny state authority to act in a way that would undermine the purposes of federal law.")

full effect to FERC-filed rates that affected the utilities' cost of retail service. Applying the filed rate doctrine, this Court held that the states' departures from the FERC-filed rates obstructed accomplishment of Congress' intent in the Federal Power Act and thus violated the Supremacy Clause. *Mississippi Power*, 487 U.S. at 373; *Nantahala*, 476 U.S. at 966-67.

In limiting FERC's authority on the basis of the buyer-seller distinction, the Kansas court failed to grasp that the central focus of *Nantahala* and *Mississippi Power* is the potential for state action to erode FERC's authority. The impact of state action on FERC's authority does not depend on whether the object of the state regulation is a buyer or a seller. Identical economic impacts result from a state regulator's imputation of fictitious wholesale revenues to a utility and from a regulator's pretense that a utility's wholesale power costs are lower than they actually are. Both fictions artificially reduce the utility's retail revenue requirement, allowing state regulators to fix rates to in-state customers at a level that does not accurately reflect the FERC-filed rates paid or collected.

In fact, state regulation of wholesale sellers is potentially more intrusive on FERC's jurisdiction than state regulation of wholesale purchasers. Congress' intent in passing the Federal Power Act was to provide for federal regulation of sellers of wholesale power, not buyers. *See Gulf States Utils. Co. v. FPC*, 411 U.S. 747, 758 (1973). Moreover, there arguably may be areas related to purchasers of wholesale power in which state regulatory power may operate, such as the prudence of the amount and source of the wholesale power bought. *See, e.g., New Orleans Pub. Serv., Inc. v. Council of New Orleans*, 911 F.2d 993, 1002 (5th Cir. 1990); *Pike County Light & Power Co. v. Pennsylvania Pub. Util. Comm'n.*, 77 Pa. Commw. 268, 273-74, 465 A.2d 735, 737-38 (1983). FERC's jurisdiction is less threatened

when a state inquires into the wisdom of the purchasers' decision to enter into a transaction than when a state attempts to review the economic fairness of a wholesale transaction. In this case, the KCC has intruded on the precise issue the Federal Power Act commits to FERC—whether the cost recovery from the OMPA sale was just and reasonable. *See* 16 U.S.C. § 824e(a). *Cf. FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 355 (1956) (FERC (then the FPC), in fixing just and reasonable rates, may consider whether a wholesale rate casts an excessive burden on seller's other customers).

This usurpation of FERC's prerogative is totally at odds with the preemption principles announced in *Nantahala* and *Mississippi Power* and is precisely what the filed rate doctrine prohibits. This Court held there that the filed rate doctrine requires state regulators to give *full* effect to FERC-filed wholesale rates when fixing retail rates:

> Once FERC sets such a rate, a state may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A state must rather give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the states do not interfere with this authority.

Nantahala, 476 U.S. at 966. *Accord Mississippi Power*, 487 U.S. at 374 ("states may not regulate in areas where FERC has properly exercised its jurisdiction to determine just and reasonable wholesale rates or to ensure that agreements affecting wholesale rates are reasonable.").[20]

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[20] This principle has special applicability here, where a state has redesigned a wholesale transaction to benefit its own citizens. The Federal Power Act was enacted as a "direct result" of this Court's holding in *Pub. Utils. Comm'n v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927), in which the Court recognized that states could disrupt interstate transactions if allowed to regulate such trans-

FERC's authority cannot be plenary if the states in setting retail rates retain the power to disregard the wholesale revenues FERC fixes or allows. Retail rates must reflect those wholesale costs and revenues if the utility is to maintain its financial footing. Permitting the states to set retail rates by altering the FERC-filed revenue collected by the utility is tantamount to permitting the states to regulate interstate sales of electricity at wholesale. To avoid the trap in which KG&E is caught, exposed to having a portion of its costs permanently trapped by the KCC's refusal to give full effect to KG&E's FERC-filed rates, wholesalers will have to look to local regulators before making an interstate sale of power. State regulators, not FERC, will make the effective determination of what wholesale power sales are appropriate based on their concern for furthering local interest. Such a result is wholly inconsistent with the congressional objective embodied in the Federal Power Act and the preemptive force given that legislative intent by the Supremacy Clause.

Giving full effect to Congress' grant of plenary authority to FERC requires a recognition that in fixing or allowing rates, FERC necessarily has jurisdiction over both sides of the buy-sell equation. FERC's authority under the Federal Power Act is limited to fixing or allowing "just and reasonable" rates (App. 184a), which requires that a seller receive no more than a fair price for what it actually sells. The KCC's imputation of phantom revenue, accomplished by including items in an interstate sale not considered by FERC when it allowed the rate, interferes with FERC's mandate to set just and reasonable rates. When the effect of state action is to interfere with FERC's authority, the state action is pre-

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actions in furtherance of their "respective local interests." *Id.* at 89-90. *See Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S 375, 378 (1983).

empted. *Maryland v. Louisiana,* 451 U.S. 725, 746-52 (1981).

The Kansas court, by reading *Nantahala* and *Mississippi* narrowly and limiting the principles in those cases to the specific facts presented there, concluded that no interference with FERC's jurisdiction existed. That court's decision to examine preemption issues on a case-by-case basis in an attempt to avoid finding preemption is inconsistent with the intent of Congress in enacting the Federal Power Act:

> Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction making unnecessary . . . case-by-case analysis. This was done in the Power Act by making FPC jurisdiction plenary and extending it to all wholesale sales in interstate commerce. . . .

FPC v. Southern California Edison Co., 376 U.S. 205, 215-16 (1964).

By imputing phantom revenue to the OMPA sale, Kansas crossed over this bright line. The KCC rejected KG&E's FERC-filed rate and applied instead a fictitious wholesale power rate specifically designed to benefit KG&E's in-state ratepayers. In doing so, the KCC determined for itself what constituted a fair rate for KG&E's sale of power to OMPA. The Federal Power Act requires that FERC, not an affected state, make such decisions. The KCC, like all state regulators, will always be able to find that some part of an interstate transaction unfairly burdens its fellow citizens and unfairly benefits the citizens of another state.[21] The "bright

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[21] Section 206 of the Federal Power Act, 16 U.S.C. § 824e (App. 186a), provides state regulators and consumer advocates with ample opportunity to challenge the reasonableness of a wholesale transaction. Despite the availability of such proceedings and despite its current claim that the OMPA sale unfairly burdens Kansas ratepayers, the KCC and CURB made no effort to seek redress through the procedures of the Federal Power Act. Having failed to do so, the KCC was precluded from considering CURB's collateral attack on the fairness of the OMPA sale, even as to matters

line" of FERC's plenary jurisdiction was intended to remove such state interests from the regulation of interstate power transactions.

If the flow of power across state lines is to continue unimpaired, the conflict between FERC's authority over sellers of wholesale power and state attempts to shape wholesale rate structures to further their parochial interests should be resolved now.

CONCLUSION

The Court should grant a Writ of Certiorari and set the case for full briefing and argument on the merits. The federal issue is too important, and has too great an impact on interstate wholesale power sales, for the Kansas courts and regulators to be permitted to ignore the supremacy of federal law unimpeded.

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not actually raised before FERC. *Mississippi Power*, 487 U.S. at 374-75. *Cf. City of Tacoma v. Taxpayers of Tacoma*, 357 U.S. 320, 334-37 (1958) (Federal Power Act's specific provisions for judicial review necessarily preclude any other form of judicial review or *de novo* litigation of all matters involved in the controversy).